



# City of New York

## OFFICE OF THE COMPTROLLER

John C. Liu

COMPTROLLER



## FINANCIAL AUDIT

**Tina Kim**

Deputy Comptroller for Audit

Audit Report on the Compliance of the  
Marriott Marquis with Its City Lease  
Agreement

FK12-065A

February 11, 2013

<http://comptroller.nyc.gov>



THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
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John C. Liu  
COMPTROLLER

February 11, 2013

**To the Residents of the City of New York:**

My office has audited the compliance of the Marriott Marquis with its City lease agreement to operate the Times Square Marriott Marquis Hotel located at 1535 Broadway between 45<sup>th</sup> and 46<sup>th</sup> Streets in Manhattan. We audit entities such as the Marriott Marquis to ensure that they accurately report revenues, pay the City all money due it, and comply with other significant lease terms.

Under the terms of its agreement, the Marriott Marquis was to develop a first-class hotel and make payments to the City based, in part, on revenue. Accordingly, the Marriott Marquis was required to annually submit to the City certified financial statements and maintain detailed books and records for at least six years.

The audit found that the Marriott Marquis owes the City \$3.6 million for an outstanding payment of \$1.9 million and additional compounded semi-annual interest of \$1.7 million. Additionally, the Marriott Marquis failed to keep detailed financial records for more than 20 years, rendering the City unable to verify the accuracy of reported revenues and revenue-based payments for the entire lease term. This occurred, in part, because the Department of Citywide Administrative Services (DCAS) did not adequately monitor the Marriott Marquis to ensure compliance and accurate financial reporting.

Our review also found that the Economic Development Corporation (EDC) advised the City to execute a lease amendment that was not in the City's best interests, in large part, because it provided for vastly reduced purchase, rent, and interest payments. Based on available documentation, EDC did not perform appropriate quantitative analyses comparing purchase, rent, and interest revenue under the original and amended lease terms or adequately disclose to the City all relevant issues. Most notably, EDC did not disclose to the City that, at the time of the amendment, it would lose land sale revenue of \$75 million as well as significant rent and interest revenue.

The results of our audit have been discussed with Marriott Marquis, DCAS, and EDC officials, and their comments have been considered in preparing this report. Their complete written responses are attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at [audit@comptroller.nyc.gov](mailto:audit@comptroller.nyc.gov).

Sincerely,

John C. Liu

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# THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER FINANCIAL REPORTING

## Audit Report on the Compliance of the Marriott Marquis with Its City Lease Agreement

FK12-065A

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### AUDIT REPORT IN BRIEF

On July 2, 1982, Times Square Hotel, Inc., a wholly-owned subsidiary of the Empire State Development Corporation (ESDC), and the Times Square Marquis Hotel, L.P. (the Marriott Marquis) entered a 75-year lease for the premises located at 1535 Broadway between 45th and 46th Streets in Manhattan. Simultaneously, ESDC, the Marriott Marquis, and the City entered a three-party agreement naming the City as the third-party beneficiary to this lease. These agreements provided for the Marriott Marquis to: purchase the land and immediately convey title to the State and the City; develop a first-class hotel on the land; and pay the City rent for each year of the 75-year lease term. A portion of this rental payment was payable within 120 days after the current lease year, and the balance was payable with 10 percent simple interest per annum upon the sale of the land to the Marriott Marquis or lease expiration, i.e., July 1, 2057. Since rental payments were based, in part, on revenue, the Marriott Marquis was required to annually submit to the City certified financial statements and “keep and maintain...full and accurate books of accounts and records” for at least six years. These agreements also allowed the Marriott Marquis an option to purchase the property for an amount equal to the fair market value of the land.

In 1998, the Marriott Marquis proposed and, upon the New York City Economic Development Corporation’s (EDC) recommendation, the City agreed to amend the lease rent, interest, purchase, term, and other provisions. The amended lease: provided for the Marriott Marquis to make a fixed payment and/or a payment based on its gross operating revenue for the period October 1, 1998, to December 31, 2007, and real estate tax-based payments thereafter; reduced the interest rate to 5.04 percent, compounded semi-annually; provided for a purchase price that is the greater of a formula-based price or fixed price of \$19.9 million; and shortened the lease term by 40 years, i.e., to 2017.

As the third-party beneficiary of Marriott Marquis payments, the Department of Citywide Administrative Services (DCAS) was responsible for monitoring the Marriott Marquis to ensure that it complied with financial reporting, record-keeping, and other significant lease terms, and remitted all money due the City. For the lease years ending December 31, 2006, and 2007, the Marriott Marquis reported revenues of \$309.5 and \$343.4 million and paid the City \$15.5 and

\$17.2 million, respectively. And for the lease years ending December 31, 2008, 2009, and 2010, the Marriott Marquis made real estate tax-based payments of \$17.9, \$21, and \$20.4 million, respectively.

## **Audit Findings and Conclusions**

The Marriott Marquis owes the City \$3.6 million in interest. Under the terms of the amended lease, the Marriott Marquis was required to pay the City 5.04 percent interest, compounded semi-annually, on Accrued Unpaid Rent. On January 29, 1999, the Marriott Marquis made a lump-sum payment of \$53.4 million to EDC composed of loan, rent, and Accrued Unpaid Rent payments. However, the Marriott Marquis did not remit to the City the associated Accrued Unpaid Rent interest of nearly \$1.9 million. Consequently, the Marriott Marquis owes the City the outstanding \$1.9 million of interest, which compounded semi-annually, totals \$3.6 million.

Additionally, the Marriott Marquis failed to “keep and maintain...full and accurate books of accounts and records” to enable the City to confirm reported revenue and ensure that the City received all money due it. Two previous audits issued in 1990 and 1997 also cited the Marriott Marquis for failing to retain and produce critical records to substantiate reported revenues. For more than 20 years (1986 through 2007), the Marriott Marquis disregarded the records retention provision of its lease and thus rendered the City unable to verify the accuracy of the Marriott Marquis’ reported revenues and revenue-based payments for the entire lease term. This occurred, in part, because DCAS did not adequately monitor the Marriott Marquis to ensure compliance and accurate financial reporting.

Our review also found that EDC advised the City to execute a lease amendment that was not in the City’s best interests, in large part, because it provided for vastly reduced purchase, rent, and interest payments. When evaluating lease terms and advising the City on real estate matters, EDC should exercise due care and diligence to determine and document whether terms are fair, equitable, and in the City’s best interests. EDC should then adequately and clearly disclose to the City the advantages and disadvantages of proposed terms. However, based on available documentation, EDC did not perform appropriate quantitative analyses comparing purchase, rent, and interest revenue under the original and amended lease terms or adequately disclose to the City all relevant issues. Most notably, EDC did not disclose to the City that, at the time of the amendment, it would lose land sale revenue of \$75 million as well as significant rent and interest revenue.

## **Audit Recommendations**

To address these issues, we make seven recommendations—one to the Marriott Marquis, three to DCAS, and three to EDC.

The Marriott Marquis should immediately remit \$3,643,468 to the City—the initial interest payment of \$1,867,773 along with additional accumulated interest of \$1,775,695 as of July 1, 2012.

With regard to the Marriott Marquis lease agreement, DCAS should ensure that the Marriott Marquis remits \$3,643,468 to the City. And with regard to its lessees that pay revenue-based rents, DCAS should:

- Conduct routine audits or other reviews to ensure that lessees retain required financial records, accurately report revenues, and pay the City all money due it.
- Take appropriate enforcement action and follow up in a timely manner on lessees' non-compliance.

When evaluating lease terms, EDC should:

- Exercise due care and diligence to determine and document whether lease terms are fair, equitable, and in the City's best interests. This should include, but not be limited to, conducting and retaining comparative quantitative analyses of the financial-related terms.
- Document the advantages and disadvantages of proposed terms.
- Publicly disclose and discuss significant proposed lease amendments prior to approval and execution.

## **Auditee Responses**

In their responses, the Marriott Marquis, DCAS, and EDC either did not agree with or did not acknowledge the report's findings and recommendations.

With regard to the \$3.6 million owed to the City, the Marriott Marquis and DCAS claim that the Marriott Marquis made its initial Accrued Unpaid Rent interest payment and, therefore, does not owe the City any money. However, the Marriott Marquis and DCAS offer inconsistent explanations as to how this payment was made. Moreover, the Marriott Marquis' 1998 certified financial statements refute these varying explanations and evidence that the \$3.6 million is, in fact, owed the City.

The Marriott Marquis and DCAS did not dispute that the Marriott Marquis failed to retain source records to support reported revenues upon which payments were based. Nor did they dispute the critical importance of such records. Nevertheless, DCAS refused to acknowledge or implement recommendations aimed at ensuring that DCAS lessees retain required financial records, accurately report revenues, and pay the City all money due it.

EDC did not acknowledge the report's most significant finding, i.e., that EDC did not perform comparative analyses to determine and document whether Marriott Marquis' amended lease terms were fair and equitable and, consequently, advised the City to enter an agreement that was not in its best interests. Instead, EDC trivialized it as a records-retention issue, maintaining that documents evidencing the deal's benefits were 15 years old and thus "difficult for any organization to identify and locate." Additionally, EDC claimed that the audit failed to take "into account anticipated community and economic development." However, while such benefits are significant and were relevant to and factored into initial Marriott Marquis lease terms negotiated in 1982, they are not applicable to the amended terms negotiated in 1998. In 1998, when the Marriott Marquis proposed amending its lease, Times Square was a successfully redeveloped, burgeoning real-estate market.

# INTRODUCTION

## Background

The Marriott Marquis is located in the heart of Times Square and contains more than 1,800 guest rooms and 57 suites. The Marriott Marquis is a popular destination for leisure and business travelers from around the world and reports the highest occupancy rate of all New York City hotels.

On July 2, 1982, Times Square Hotel, Inc., a wholly-owned subsidiary of ESDC<sup>1</sup>, and the Marriott Marquis<sup>2</sup> entered a 75-year lease for the premises located at 1535 Broadway between 45th and 46th Streets in Manhattan. Simultaneously, ESDC, the Marriott Marquis, and the City entered a three-party agreement naming the City as the third-party beneficiary to this lease. The agreement provided for the Marriott Marquis to purchase the land and immediately convey title to the State and the City. The agreement also required the Marriott Marquis to develop a first-class hotel on the land containing: approximately 2,000 rooms, restaurants, a theater, bars, lounges, ballrooms, an exhibition hall, retail space, meeting rooms, parking facilities, a billboard, and other amenities and improvements. The three-party agreement required the Marriott Marquis to pay the City rent for each year of the 75-year lease term—a portion of which was payable within 120 days after the current lease year, i.e., the minimum payment<sup>3</sup>, and the balance of which was payable with interest upon the sale of the land to the Marriott Marquis or lease expiration date in 2057, i.e., Deferred Base Rent, as well as 10 percent simple interest per annum on deferred rents. The Marriott Marquis was required to annually submit to the City certified financial statements, including Statements of Gross Operating Revenues, Base Rent, and Minimum Payments. Further, the Marriott Marquis was required to “keep and maintain...full and accurate books of accounts and records” for at least six years. The agreement also allowed the Marriott Marquis an option to purchase the property for an amount equal to the fair market value of the land upon lease expiration i.e., July 1, 2057.

In 1998, the Marriott Marquis proposed and, upon EDC’s recommendation, the City agreed to amend the lease. Effective October 1, 1998, the lease rent, interest, purchase, term, and other provisions were amended. Under the amendment, the Marriott Marquis would: make a fixed payment and/or a payment based on its gross operating revenue for the period October 1, 1998, to December 31, 2007, and real estate tax-based payments thereafter; reduce the Accrued Unpaid Rent<sup>4</sup> interest rate to 5.04 percent, compounded semi-annually; provide for a purchase

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1 ESDC was formerly known as the New York State Urban Development Corporation.

2 The Times Square Marquis Hotel, L.P. was formerly known as the Times Square Hotel Company.

3 For the period October 1, 1985, to September 30, 2000, the Marriott Marquis was required to pay: Base Rent = \$900,000 + Applicable Percentage multiplied by (7 percent Gross Operating Revenues - \$900,000). For the Lease Year ending September 30, 1986, the Applicable Percentage was 25 percent, and it increased 5 percent per Lease Year thereafter until it equals 100 percent.

4 Per section 3.22 (a) of the amendment dated October 1, 1998, the “total unpaid Deferred Base Rent (as defined in the Original Lease) and accrued interest on Deferred Base Rent (as defined in the Original Lease) as of the Amendment Date” are to be collectively known as Accrued Unpaid Rent.

price that is the greater of a formula-based price<sup>5</sup> or fixed price of \$19.9 million; and shorten the lease term by 40 years, i.e., to 2017.

Upon restructuring the lease, EDC received all payments on behalf of the City and remitted these payments to the New York City Office of Management and Budget (OMB) on its direction. In turn, OMB credited payments to DCAS. As the third-party beneficiary of the Marriott Marquis payments, DCAS was responsible for monitoring the Marriott Marquis to ensure that it complied with financial reporting, record-keeping, and other significant lease terms, and remitted all money due the City.

For the lease years ending December 31, 2006, and 2007, the Marriott Marquis reported revenues of \$309.5 and \$343.4 million and paid the City \$15.5 and \$17.2 million, respectively. And for the lease years ending December 31, 2008, 2009, and 2010, the Marriott Marquis made real estate tax-based payments of \$17.9, \$21, and \$20.4 million, respectively.

## Objectives

The objectives of this audit were to determine whether the Marriott Marquis:

- accurately reported gross operating revenue and calculated payments due to the City;
- submitted payments within specified timeframes; and
- complied with other significant lease terms, such as maintaining required financial records and insurance and paying taxes and utilities.

## Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions except for our inability to obtain sufficient, appropriate evidence to determine whether the Marriott Marquis accurately reported gross operating revenue for the period October 1, 2006, through December 31, 2007, and thus, whether the Marriott Marquis paid the City all revenue due it. This issue is more fully disclosed in the subsequent paragraphs. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

To determine whether the Marriott Marquis accurately reported revenue for the period October 1, 2006, through December 31, 2007, we requested that the Marriott Marquis provide us source documentation substantiating reported gross operating revenues. Specifically, we requested that the Marriott Marquis substantiate reported room rental revenue of approximately \$270 million because this accounts for the majority of revenue. However, the Marriott Marquis did not

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<sup>5</sup> The purchase price formula is equal to: (Base Purchase Price of \$25 million) + (Interest on Base Purchase Price) – (Sum of Discounted Base Rent Payments).



maintain Hotel Folios given to guests upon check-out that detail all charges and Room and Tax Reports detailing guest arrival and departure dates and room rates. The Marriott Marquis was also cited for failing to maintain these critical records in two previous audits.

Because the Marriott Marquis lacked detailed sales records, we intended to estimate revenues based on Marriott Marquis cash receipts for the period October 1, 2006, through December 31, 2007. Because credit card receipts account for the majority of the Marriott Marquis' cash receipts, we requested third-party credit card processor reports detailing Marriott Marquis' credit card terminal activity for rooms, catering, food and beverage, and other charges. We also requested Marriott Marquis monthly bank statements evidencing electronic fund transfer payments received from credit card processors. However, Marriott Marquis officials informed us that with regard to third-party credit card processor reports, "we can not [sic] get past activity from the years in question." Marriott Marquis officials also informed us credit card processors do not remit payments directly to the Marriott Marquis. Rather, these payments are made to a Marriott Hotel Group centralized processing center and then sent back to the Marriott Marquis net of expenses. Because we were not able to perform intended or alternative procedures, we were not able to determine whether the Marriott Marquis accurately reported gross operating revenue for the year in question and paid the City all revenue due it.

For the period January 1, 2008, through December 31, 2010, the Marriott Marquis made real estate tax-based payments. Therefore, we were able to verify Marriott Marquis' payments for this period.

The scope of this audit was October 1, 2006, through December 31, 2010. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

## **Discussion of Audit Results**

The matters covered in this report were discussed with Marriott Marquis, DCAS, and EDC officials during and at the conclusion of this audit. A preliminary draft report was sent to Marriott Marquis, EDC, and DCAS officials and discussed at an exit conference held on November 15, 2012. On November 30, 2012, we submitted a draft report to the Marriott Marquis, DCAS, and EDC officials with a request for comments. We received written responses on December 14, 2012, in which the Marriott Marquis, DCAS, and EDC either did not agree with or did not acknowledge the report's findings and recommendations.

With regard to the \$3.6 million owed to the City, the Marriott Marquis and DCAS claim that the Marriott Marquis made its initial Accrued Unpaid Rent interest payment and, therefore, does not owe the City any money. However, the Marriott Marquis and DCAS offer inconsistent explanations as to how this payment was made. Moreover, the Marriott Marquis' 1998 certified financial statements refute these varying explanations and evidence that the \$3.6 million is, in fact, owed the City.

The Marriott Marquis and DCAS did not dispute that the Marriott Marquis failed to retain source records to support reported revenues upon which payments were based. Nor did they dispute the critical importance of such records. Nevertheless, DCAS refused to acknowledge or implement recommendations aimed at ensuring that DCAS lessees retain required financial records, accurately report revenues, and pay the City all money due it.

EDC did not acknowledge the report's most significant finding, i.e., that EDC did not perform comparative analyses to determine and document whether Marriott Marquis' amended lease terms were fair and equitable and, consequently, advised the City to enter an agreement that was not in its best interests. Instead, EDC trivialized it as a records-retention issue, maintaining that documents evidencing the deal's benefits were 15 years old and thus "difficult for any organization to identify and locate." Additionally, EDC claimed that the audit failed to take "into account anticipated community and economic development." However, while such benefits are significant and were relevant to and factored into initial Marriott Marquis lease terms negotiated in 1982, they are not applicable to the amended terms negotiated in 1998. In 1998, when the Marriott Marquis proposed amending its lease, Times Square was a successfully redeveloped, burgeoning real-estate market.

## FINDINGS

The Marriott Marquis owes the City \$3.6 million in Accrued Unpaid Rent interest. Under the terms of the amended lease, the Marriott Marquis was required to pay the City 5.04 percent interest, compounded semi-annually, on Accrued Unpaid Rent. On January 29, 1999, the Marriott Marquis made a lump-sum payment of \$53.4 million to EDC composed of loan, rent, and Accrued Unpaid Rent payments. However, the Marriott Marquis did not remit to the City the initial Accrued Unpaid Rent interest of \$1.9 million. Nevertheless, EDC erroneously credited the Marriott Marquis for making its initial Accrued Unpaid Rent interest payment and DCAS subsequently certified it. Consequently, the Marriott Marquis owes the City the outstanding \$1.9 million of interest, which compounded semi-annually, totals \$3.6 million as detailed in Appendix I.

Further, the Marriott Marquis failed to maintain books and records to substantiate the Gross Operating Revenue it reported to the City. Under the lease agreement, the Marriott Marquis was required to annually submit to the City certified statements of gross operating revenue and “keep and maintain...full and accurate books of accounts and records” to enable the City to confirm reported revenue and ensure that the City received all money due it. The lease also stipulated that such records be maintained for at least six years. In response to our initial documentation request, Marriott Marquis’ officials stated that, due to the massive volume of records, archived files go as far back as January 2008 only—that is the exact time that the Marriott Marquis’ payment to the City was no longer revenue-based. Consequently, we were not able to determine whether the Marriott Marquis has reported all its revenues and made all revenue-based payments to the City. Two previous audits issued in 1990 and 1997 also cited the Marriott Marquis for failing to retain and produce critical records to substantiate reported revenues. For more than 20 years (1986 through 2007), the Marriott Marquis disregarded the records retention provision of its lease and thus rendered the City unable to verify the accuracy of the Marriott Marquis’ reported revenues and revenue-based payments for the entire lease term. The Marriott, however, complied with other significant lease terms such as generally maintaining the appropriate types and amounts of insurance and paying taxes and water and sewer charges.

Our review also found that DCAS did not adequately administer the lease to ensure the Marriott Marquis’ compliance. As the agency responsible for monitoring the lease, DCAS should ensure that Marriott Marquis complies with financial reporting and record-keeping and other terms of its lease. However, our review found that DCAS did not ensure the Marriott Marquis maintained comprehensive books and records and did not conduct reviews to determine whether rent payments owed to the City were properly calculated.

Furthermore, our review found that EDC advised the City to execute a lease amendment that was not in the City’s best interests, in large part, because it provided for vastly reduced purchase, rent, and interest payments. When evaluating lease terms and advising the City on real estate matters, EDC should exercise due care and diligence to determine and document whether terms are fair, equitable, and in the City’s best interests. EDC should then adequately and clearly disclose to the City the advantages and disadvantages of proposed terms. However, based on available documentation, EDC did not perform appropriate quantitative analyses comparing purchase, rent, and interest revenue under the original and amended lease terms or adequately disclose to the City all relevant issues. Most notably, EDC did not disclose to the City that, at the time, it would lose land sale and rent revenue as well as significant interest revenue. For example, our review found that, as of the amendment date, the City would lose

land sale revenue of \$75 million—the Department of Finance (Finance) assessed Fair Market Value at \$100 million versus \$25 million Base Purchase Price. These matters are discussed in detail in the following sections of this report.

## **The Marriott Marquis Owes the City \$3.6 Million**

The Marriott Marquis owes the City \$3.6 million in initial Accrued Unpaid Rent interest. Under the terms of the 1998 amended lease, the Marriott Marquis was required to pay the City “Accrued Unpaid Rent, together with interest on the principal amount outstanding from the Amendment Date at a rate equal to Five and Four Hundredths Percent (5.04%) per annum, compounded semiannually.” Accordingly, the Marriott Marquis should have paid the City interest of \$1,867,773 for the period October 1, 1998, to January 29, 1999. However, the Marriott Marquis did not make this payment.

According to the Marriott Marquis’ payment records on file with EDC and DCAS, on January 29, 1999, the Marriott Marquis made a lump-sum payment of \$53,346,589 to EDC on behalf of the City. However, it did not remit the initial Accrued Unpaid Rent interest payment of \$1,867,773 along with its initial principal and other payments. Our review also found that neither EDC nor DCAS ensured that this interest payment was made. EDC received and retained the lump-sum payment of \$53,346,589 and now maintains that a portion of this payment—\$1,124,625—represented the initial interest payment which was reduced based on a “renegotiated interpretation of the debt service deduction section of the original lease agreement.” However, the \$1,124,625 was a payment of rent and not interest as evidenced by EDC’s own rationale. Debt service deductions pertain to the original lease minimum rent payment formula and not to interest. Interest—whether calculated under original or amended lease terms—is based only on three factors: principal, interest rate, and time. Nevertheless, EDC erroneously credited the Marriott Marquis for making its initial Accrued Unpaid Rent interest payment and DCAS subsequently certified it. As a result, the City never received the initial interest payment on Accrued Unpaid Rent. Consequently, we calculate that the Marriott Marquis owes the City a total of \$3,643,468, consisting of \$1,867,773 in initial interest payment and \$1,775,695 in additional accumulated interest, compounded semi-annually, as detailed in Appendix I.

**Marriott Marquis Response:** With regard to its assertion that the Marriott Marquis made all payments due under the lease, the Marriott Marquis stated “pursuant to Section 3.22(c), Marriott’s \$24,823,355 payment was allocated as follows: (i) \$20 million of the payment went to pay down the Accrued Unpaid Rent, (ii) \$1,867,773 went to interest on the Accrued Unpaid Rent, and (iii) the remainder, \$2,955,582, went to Base Rent and was applied against the eventual purchase price of the hotel land.”

**Auditor Comment:** During the course of the audit, the Marriott Marquis maintained that its initial Accrued Unpaid Rent interest payment was renegotiated to \$1.1 million and that this reduced amount was included in the Marriott Marquis’ \$24.8 million payment made in January 1999. However, upon disproving this explanation, the Marriott Marquis now claims that the full interest payment of \$1.8 million was made and included in the \$24.8 million payment. The Marriott Marquis then argues that, if the initial Accrued Unpaid Rent interest payment was not made, the City is barred from pursuing collection by a 1999 estoppel certificate and the statute of limitations, as detailed below.

The Marriott Marquis' current allocation of the \$24.8 million is erroneous and *contrary to its own 1998 certified financial statements*, which correctly recognize that the \$24.8 million payment was made up of:

- \$20 million representing its initial Accrued Unpaid Rent principal payment, and
- \$4.8 million representing ground rent for the period October 1 through December 31, 1998, i.e., the interim period between the initial and amended lease.

Therefore, we reiterate that the Marriott Marquis did not remit its initial Accrued Unpaid Rent interest payment and, as a result, it owes the City \$3.6 million.

**Marriott Marquis Response:** “[O]n June 30, 1999, the Landlord issued an estoppel...certifying that there was no Event of Default and that ‘[a]ll of the rent and other charges required to be paid by Tenant under the Lease have been duly and timely paid.’ The Second Amendment provides that Marriot could rely upon such an estoppel statement.<sup>9</sup>

The Second Amendment provides, in pertinent part:

Section 31.02 of the Lease is hereby amended . . . as follows:“Landlord agrees . . . to execute, acknowledge and deliver to Tenant . . . a statement in writing (which may be relied upon by any Person) . . . (b) stating (i) whether or not an Event of Default . . . shall have occurred . . . and (ii) whether or not, to the best knowledge of Landlord, Tenant is in Default in the performance of any covenant, agreement, obligation or condition contained in this Lease, and, if so, specifying, in detail, each such Default or Event of Default, and (c) setting forth the amount of Accrued Unpaid Rent most recently certified by Tenant to Landlord and indicating whether or not Landlord is then disputing the amount of Accrued Unpaid Rent so certified by Tenant. . . .”

“The Landlord's estoppel certificate thus not only confirms that in 1999 the Landlord understood that there was no Event of Default and that Marriott had made all required payments, it also estops the City from now claiming that Marriott failed to make an interest payment in 1999.”

**Auditor Comment:** The Marriott Marquis is disingenuous in maintaining that a City letter sent to the Marriott Marquis' mortgage holders “estops the City from now claiming the Marriott failed to make an interest payment in 1999.” This is nothing more than a confirmation letter issued for limited banking purposes and does not waive the City's right to contest payments due it. The Marriott Marquis correctly cites section 31.02 of its lease regarding estoppel certificates, but omits the truly “pertinent” proviso that “such statement by Landlord shall not be nor be deemed to be a waiver by Landlord of its right to thereafter contest the amount of Accrued Unpaid Rent so certified by Tenant.”

**Marriott Marquis Response:** “Finally, any claim for re-payment of the \$1.8 million interest amount at issue is untimely and barred by the statute of limitations. Section 213(2) of New York's Civil Practice Law and Rules provides for a six-year statute of limitations....”

**Auditor Comment:** While the Marriott Marquis is correct as a matter a law, it is not correct as a matter of principle. As detailed, the Marriott Marquis benefitted tremendously from doing business with the City—particularly from its amended lease terms. As detailed, the Marriott Marquis was allowed to amortize rent accrued from July 1, 1982, to September 30, 1998, in lieu of making current rent payments—forgoing the tax implications of debt forgiveness—and was also afforded a substantially reduced purchase price and interest rate. These amended terms benefitted the Marriott Marquis by at least \$344.9 million (\$173.1 million for reduced purchase price and \$171.8 million for payments applied to Accrued Unpaid Rent in lieu of paying current rent). Therefore, as a matter of good faith, the Marriott Marquis should pay the City the \$3.6 million that it is owed.

## **The Marriott Marquis Failed to Document Reported Gross Receipts upon which Rent Was Based**

The Marriott Marquis failed to retain documentation to substantiate reported gross operating revenues upon which its payments to the City were largely based. As noted, the Marriott Marquis was required to make a fixed payment and/or a payment based on its gross operating revenue through December 31, 2007. Accordingly, the Marriott Marquis was required to annually submit to the City certified statements of gross operating revenue, and “keep and maintain...full and accurate books of accounts and records” to enable the City to confirm reported revenue and ensure that the City received all money due it. The lease also stipulated that such records be maintained for at least six years. However, the Marriott Marquis did not comply with this critical lease provision.

In its certified statements of gross operating revenue for the lease year ending December 31, 2007, Marriott Marquis reported room rental revenue of approximately \$216.4 million. Because room rental revenue accounts for the majority of the Marriott Marquis’ reported gross operating revenue, we asked that the Marriott Marquis provide us with the source documentation to support this revenue. However, Marriott Marquis officials stated that due to “the massive volume” of records, its “archived files go as far back as January 2008 only”—the exact time that the Marriott Marquis’ payment to the City was no longer revenue-based.

Two previous audits issued in 1990 and 1997 also cited the Marriott Marquis for failing to retain and produce critical records to substantiate reported revenues. For more than 20 years, the Marriott Marquis disregarded the records retention provision of its lease and thus rendered the City unable to verify the accuracy of the Marriott Marquis’ reported revenues and revenue-based payments for the entire lease term. For the period October 1985 to December 2007 (i.e., the period for which the Marriott Marquis made revenue-based payments), the Marriott Marquis reported gross operating revenues totaling \$4.4 billion and made payments to the City totaling \$160.3 million. Because of the magnitude of the revenue and payments associated with this lease, the Marriott Marquis’ repeated failure to retain and produce critical records to substantiate reported revenues constitutes a significant breach of its lease.

## Other Matters

### DCAS Did Not Adequately Monitor to Ensure Compliance with the Lease

DCAS did not adequately monitor the lease to ensure the Marriott Marquis' compliance. As the beneficiary of lease payments, DCAS had an inherent responsibility to monitor the Marriott Marquis and ensure that it complied with financial reporting and record-keeping and other terms of its lease. However, DCAS did not:

- *Follow up on significant audit findings.* As noted, the Marriott Marquis was twice cited for failing to maintain source documentation to support reported revenues upon which the Marriott Marquis' payments to the City were largely based. Despite these findings, DCAS did not conduct follow-up reviews or audits to ensure that the Marriott Marquis retained required records, accurately reported revenues, and paid the City all money due it. And the Marriott Marquis continued to circumvent its lease requirements, which limited the City's ability to ascertain the accuracy of the Marriott Marquis' reported revenues and revenue-based payments for the entire lease term.

**DCAS Response:** "It is true, in the case of the Marriott, that there has been reliance by DCAS on the work of public accounting and auditing firms in determining annual revenues. DCAS is not aware nor does it have any reason to believe that there were any material misstatements in these documents. Therefore, DCAS has utilized them and assessed this lease to be of lower risk than others."

**Auditor Comment:** We do not understand how DCAS could assess the Marriott Marquis lease "to be of lower risk" and claim that it had no reason to audit the Marriott Marquis and question its reported revenues and payments to the City. As noted, for the period October 1985 to December 2007 (i.e., the period for which the Marriott Marquis made revenue-based payments), the Marriott Marquis reported gross operating revenues totaling \$4.4 billion and made payments to the City totaling \$160.3 million. Because of the magnitude of the revenue and payments associated with this lease and the Marriott Marquis' repeated failure to retain and produce critical records to substantiate reported revenues, DCAS should have assessed the Marriott Marquis as a high risk and ensured that follow-up reviews or audits were conducted.

- *Certify the Marriott Marquis' \$112.8 million Deferred Base Rent calculation.* Under the terms of the original lease, the Marriott Marquis was required only to make annual minimum rent payments and allowed to defer the balance until the sale or lease expiration date. These deferred balances accrued simple interest of 10 percent per annum. Upon execution of the second amendment, ESDC—the nominal landlord—and the Marriott Marquis estimated that these deferred balances and interest, collectively referred to as Accrued Unpaid Rent, totaled \$114.0 million. A preliminary repayment schedule (referred to as Schedule A-1) detailed Accrued Unpaid Rent principal and interest payments to be made to satisfy this amount. The amendment stipulated that the Marriott Marquis should "notify Landlord of the actual amount of Accrued Unpaid Rent owed by Tenant to Landlord as of the Amendment Date pursuant to the Original Lease and shall

deliver to Landlord a revised Schedule A-1 reflecting such actual amount.” As the beneficiary of these payments, DCAS should have independently verified the Marriott Marquis’ reported Accrued Unpaid Rent figure of \$112.8 million and certified the revised Schedule A-1. However, DCAS did not do so. Consequently, we are not reasonably assured that this figure is correct.

- *Ensure that the Marriott Marquis Remitted All Payments to the City.* As noted, the Marriott Marquis reported that it owed Accrued Unpaid Rent of \$112.8 million as of the amendment execution date. And in its revised Schedule A-1, the Marriott Marquis indicated that it made initial Accrued Unpaid Rent principal and interest payments of \$20 and \$1.9 million, respectively. Although the Marriott Marquis did not, in fact, make this interest payment of \$1.9 million, DCAS certified that both the principal and interest payment were made. Consequently, the City lost interest revenue due it.

**DCAS Response:** “It has been the mutual understanding of the Marriott, EDC and DCAS, that the interest due in 1999 was negotiated to a lesser amount as part of this deal, and included as a subset of an initial payment of \$28.97 million from the Marriott to the City.”

**Auditor Comment:** This was the initial explanation offered to the audit team by all three parties—the Marriott Marquis, DCAS, and EDC. In its response, the Marriott Marquis now offers an alternate explanation as to how the \$1.8 million interest payment was satisfied. However, as previously detailed, this explanation is erroneous and *contrary to its own 1998 certified financial statements*.

## EDC Negotiated a Lease Amendment that Was Not in the City’s Best Interest

EDC advised the City to execute a lease amendment that was not in the City’s best interests, in large part because it provided for vastly reduced purchase, rent, and interest payments. When evaluating lease terms and advising the City on real estate matters, EDC should exercise due care and diligence to determine and document whether terms are fair, equitable, and in the City’s best interests. EDC should then adequately and clearly disclose to the City the advantages and disadvantages of proposed terms. However, EDC did not perform appropriate quantitative analyses comparing purchase, rent, and interest revenue under original and amended lease terms or adequately disclose to the City all relevant issues. Most notably, EDC did not disclose to the City that it would lose land sale and rent revenue as well as significant interest revenue.

In 1998, the Marriott Marquis proposed to EDC that the lease terms be amended on the basis that the Marriott Marquis would immediately pay \$20 million of the \$112.8 million of Accrued Unpaid Rent that was not due until the sale or lease expiration date, i.e., July 1, 2057; pre-pay a \$24 million loan that was not due until July 1, 2012; and transition into paying rent equivalent to taxes. In return, the Marriott Marquis proposed that the City allow the Marriott Marquis to be included in a Real Estate Investment Trust and permit an early purchase option, which would fully place the Marriott Marquis on the tax rolls. In response to this proposal, EDC advised the City that



“As detailed in the attached staff memorandum, the proposal would benefit the City by placing the hotel property on the tax rolls at a much earlier date. The hotel currently pays about \$3 million annually in PILOT. It would pay \$16 million in real estate taxes if on the tax rolls. In addition, Marriott has agreed to pay the City \$20 million to satisfy deferred rent not otherwise due until 2057 and prepay a \$24 million second mortgage loan. The funds could be applied to other economic development projects.”

However, EDC did not perform appropriate quantitative analyses comparing purchase, rent, and interest revenue under original and amended lease terms to determine and document whether the amended terms were, in fact, beneficial to the City. Further, EDC did not adequately disclose to the City all relevant issues. Most notably,

- *Purchase Option* EDC did not disclose to the City that the amended lease provided for a vastly reduced premises purchase price and, thus, that the City would lose significant land sale revenue if and when the Marriott Marquis purchased the land. In fact, EDC erroneously advised the City that under both the original and amended lease terms, the Marriott Marquis could “exercise a purchase option for \$1.” However, the original lease clearly states that the “purchase price for the Premises shall be the fair market value of the land.” And the amended lease provides for a purchase price that is the greater of:
  - a) (Base Purchase Price of \$25 million) + (Interest on Base Purchase Price) – (Sum of Discounted Base Rent Payments) or
  - b) \$19.9 million.

In 1998, when EDC advised the City to amend the Marriott Marquis lease, Finance assessed the fair market value of the land to be \$100 million. Consequently, EDC failed to advise the City that it would lose land sale revenue of \$75 million (i.e., \$100 million - \$25 million). Further, the fair market value of the land has increased since that time and is now \$193 million, representing a land sale revenue loss of \$173.1 million (i.e., \$193 million - \$19.9 million).

- *Rent* When comparing payments under the original and amended lease terms, EDC understated payments due under the original lease. EDC compared only the Marriott Marquis’ Lease Year ending September 30, 1997, minimum base rent payment of \$3.5 million to an estimated amended lease payment of \$16 million. EDC did not disclose to the City all 1997 rent and interest revenue totaling \$17.5 million composed of: minimum base rent of \$3.5 million, Deferred Base Rent of \$8.3 million, and Deferred Base Rent interest of \$5.7 million. Further, EDC did not evidence the basis for its estimated amended lease payment of \$16 million. The Marriott Marquis’ actual payments for the Lease Years ending December 31, 1999, and 2000 were only \$10 million and \$13.8 million, respectively.

More importantly, EDC did not adequately disclose to the City that the amended lease would result in the loss of significant rent revenue. As noted, the original lease required the Marriott Marquis to pay rent for each year of the 75-year lease term—a portion of which was payable within 120 days after the current lease year, i.e., the minimum base rent, and the balance of which, i.e., Deferred Base

Rent, was payable with interest upon the sale or lease expiration date. And the amended lease shortened the lease term and thus the rental payment period by 40 years. Moreover, the amended lease allowed the Marriott Marquis to pay back Deferred Base Rent and interest accrued from July 1, 1982, to September 30, 1998 (collectively referred to as Accrued Unpaid Rent under the amended lease) in lieu of paying current lease year rent. Nevertheless, EDC erroneously advised the City that the Marriott Marquis rent payments under the original and amended lease terms would be “approximately equal” for the period 1998 to 2007 and “somewhat greater” thereafter. Based on EDC’s representations, the City executed the lease amendment and, as a result, lost significant rent and interest revenue. For the period October 1, 1998, to December 31, 2007 (i.e., the actual payback period), we calculated rents payable under the original and amended lease terms and determined that the City lost rent revenue of nearly \$171.8 million.

- *Accrued Unpaid Rent Interest* EDC did not disclose to the City that the Marriott Marquis would benefit from both a significant interest rate reduction—from 10 percent simple interest per annum to 5.04 percent interest compounded semiannually—and term reduction of up to nearly 50 years. Under the original lease terms, Deferred Base Rent was payable with interest upon the sale or expiration date i.e., July 1, 2057. By allowing the Marriott Marquis to amortize Accrued Unpaid Rent in lieu of paying current rents, the Marriott Marquis was able to fully pay back Accrued Unpaid Rent by January 1, 2008. As a result, the Accrued Unpaid Rent interest term was reduced by up to nearly 50 years.

## RECOMMENDATIONS

The Marriott Marquis should:

1. Immediately remit \$3,643,468 to the City—the initial interest payment of \$1,867,773 along with additional accumulated interest of \$1,775,695 as of July 1, 2012.

**Marriott Marquis Response:** “[T]he \$1,867,773 interest payment due in January 1999 was timely paid and all findings and contentions to the contrary are incorrect....”

**Auditor Comment:** As previously detailed, the Marriott Marquis did not remit its initial Accrued Unpaid Rent interest payment. Therefore, we reiterate that the Marriott Marquis should immediately remit \$3,643,468 to the City—the initial interest payment of \$1,867,773 along with additional accumulated interest of \$1,775,695 as of July 1, 2012.

With regard to the Marriott Marquis lease agreement, DCAS should:

2. Ensure that the Marriott Marquis remits \$3,643,468 to the City.

**DCAS Response:** “Disagree. As explained above, neither DCAS, EDC, nor the Marriott can rationalize that these monies are due. Furthermore, even if DCAS believed otherwise, the attempt to collect the debt would either face significant legal challenges or the funds would be offset against future rent payments. We therefore respectfully decline this recommendation.”

**Auditor Comment:** As previously detailed, the Marriott Marquis does indeed owe the City \$3.6 million and these monies would not offset future payments. Therefore, DCAS should exercise its oversight responsibility and pursue collection as recommended.

With regard to its lessees that pay revenue-based rents, DCAS should:

3. Conduct routine audits or other reviews to ensure that lessees retain required financial records, accurately report revenues, and pay the City all money due it.

**DCAS Response:** “Not Applicable. DCAS currently utilizes a risk-based approach to target audits of individual leases. In this situation the Marriott rent is currently based upon the Real Estate Tax rather than its revenues. It is unlikely that this lease will be deemed a high risk item in the future.”

**Auditor Comment:** We are puzzled by DCAS’ refusal to acknowledge and implement this basic recommendation which aims to ensure that the City receives all money due it. At our exit conference on November 15, 2012, we clarified to DCAS that this recommendation was aimed generally at its lease monitoring practices. Specifically, we informed DCAS that these

recommendations were not applicable to its lease monitoring efforts for the Marriott Marquis because its payments are no longer revenue-based. Rather, these recommendations were applicable to DCAS' monitoring efforts for all leases in its portfolio with revenue-based lease terms. Therefore, we reiterate that, with regard to its lessees that pay revenue-based rents, DCAS should conduct routine audits or other reviews to ensure that lessees retain required financial records, accurately report revenues, and pay the City all money due it. This is especially critical given the City's current fiscal state.

4. Take appropriate enforcement action and follow up in a timely manner on lessees' non-compliance.

**DCAS Response:** "Not Applicable. Since the rent on the Marriott lease is based upon the value of Real Estate Taxes, this recommendation does not pertain to this lease. The DCAS Long Term Leasing Unit handles this function for other DCAS leases where such actions are warranted."

**Auditor comment:** We are puzzled by DCAS' refusal to acknowledge and implement this basic recommendation which aims to ensure that lessees comply with and fulfill lease terms. Again, at our exit conference, we clarified to DCAS that this recommendation was aimed generally at its lease monitoring practices. (See Auditor Comment for Recommendation # 3.) Therefore, we reiterate that, with regard to its lessees that pay revenue-based rents, DCAS should take appropriate enforcement action and follow up in a timely manner on lessees' non-compliance.

When evaluating lease terms, EDC should:

5. Exercise due care and diligence when evaluating lease terms to determine and document whether terms are fair, equitable, and in the City's best interests. This should include, but not be limited to, conducting and retaining comparative quantitative analyses of the financial-related terms.

**EDC Response:** "This recommendation has been NYCEDC's long-standing practice, even prior to this audit.

"NYCEDC retains all official records based on industry best practices, which is at least 7 years. Considering this audit required documentation and institutional knowledge from 15 years ago, from employees no longer with the company, it would be difficult for any organization to identify and locate all requested and related documents."

**Auditor Comment:** EDC is charged with managing City properties and assets in order to generate revenue while creating jobs and new business opportunities. However, EDC lacks basic procedures to ensure that it acts with due care and diligence when evaluating lease terms and advising the City on real estate matters. This resulted in a Marriott Marquis lease that was not in the City's best interests because the City stands to lose at least \$344.9 million in land sale and rent proceeds alone. Therefore, EDC should give the report's findings and recommendations proper consideration and

reevaluate its leasing practices to ensure that it optimizes revenues generated from the substantial City assets entrusted it. This is especially imperative given the City's current fiscal state.

**EDC Response:** "NYCEDC believes the Comptroller's analysis is flawed in that it fails to measure the overall beneficial economic impact on the Times Square area. NYCEDC's mission is to seek to maximize value taking into account anticipated community and economic development, relief and reduction of unemployment, growth in employment, and the development and retention of business. We believe this is a more appropriate measure of the 'City's best interests' than the Comptroller's staff used in their analysis and recommendations. The Marriott Marquis served as a major catalyst for economic growth for the Times Square area and New York City overall."

**Auditor Comment:** EDC's response only reinforces that it has a fundamental problem with its leasing practices when it asserts that we should take "into account anticipated community and economic development" when evaluating Marriott Marquis' amended lease terms. While such benefits are significant and were relevant to and factored into initial lease terms negotiated in 1982, they are not applicable to the amended terms negotiated in 1998. In the early 1980s, Times Square was a blighted area and the Marriott Marquis needed to be incentivized to develop a first-class hotel there. However, in 1998, when the Marriott Marquis proposed amending its lease, Times Square was a successfully redeveloped, burgeoning real-estate market. Consequently, it is incomprehensible that, *in 1998*, EDC would advise the City to amend the Marriott Marquis lease to afford it far more generous rent, interest, and purchase terms.

6. Document the advantages and disadvantages of proposed terms.

**EDC Response:** "This recommendation has been NYCEDC's long-standing practice, even prior to this Comptrollers' audit.

"NYCEDC retains all official records based on industry best practices, which is at least 7 years. Considering this audit required documentation and institutional knowledge from 15 years ago, from employees no longer with the company, it would be difficult for any organization to identify and locate all requested and related documents."

**Auditor Comment:** See Auditor Comment for Recommendation # 5.

7. Publicly disclose and discuss significant proposed lease amendments prior to approval and execution.

**EDC Response:** "This recommendation has been NYCEDC's long-standing practice, even prior to this Comptrollers' audit.

"Every real estate transaction NYCEDC enters into is documented and approved by a Real Estate Committee and the Board of Directors. The board

minutes of these meetings are public record and accessible to any interested party at the following weblink: <http://www.nycedc.com/about-nycedc/financial-public-documents>.”

**Auditor Comment:** While EDC may publicly disclose its Board minutes on its website, this does not allow for the same level of public disclosure, discussion, and review afforded by publication of notice in the City Record and Public Hearings. Since the City Charter mandates this level of transparency and accountability for initial leases, the same safeguards should be afforded to amendments that substantially alter significant lease terms.

**EDC Response:** “[T]he terms of the second amendment were fully disclosed and discussed with all parties to the transaction as documented by memorandum provided to the Comptrollers’ Office.”

**Auditor Comment:** Contrary to EDC’s assertion, EDC did not fully and accurately document and disclose to the City the disadvantages of proposed terms. Most notably, when EDC advised the City to amend the Marriott Marquis lease in 1998, EDC failed to advise the City that it would lose land sale revenue of \$75 million. EDC erroneously advised the City that under both the original and amended lease terms, the Marriott Marquis could “exercise a purchase option for \$1,” when, in fact, the original lease provided for a purchase price equivalent to the fair market value of the land and the amended lease provided for a vastly reduced premises purchase price that was the greater of a formula-based payment or \$19.9 million.

## DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions except for our inability to obtain sufficient, appropriate evidence to determine whether the Marriott Marquis accurately reported gross operating revenue for the period October 1, 2006, through December 31, 2007, and thus, whether the Marriott Marquis paid the City all revenue due it. This issue is more fully disclosed in the subsequent paragraphs. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

To determine whether the Marriott Marquis accurately reported revenue for the period October 1, 2006, through December 31, 2007, we requested that the Marriott Marquis provide us source documentation substantiating reported gross operating revenues. Specifically, we requested that the Marriott Marquis substantiate reported room rental revenue of approximately \$270 million because this accounts for the majority of revenue. However, the Marriott Marquis did not maintain Hotel Folios given to guests upon check-out that detail all charges and Room and Tax Reports detailing guest arrival and departure dates and room rates. The Marriott Marquis was also cited for failing to maintain these critical records in two previous audits.

Because the Marriott Marquis lacked detailed sales records, we intended to estimate revenues based on Marriott Marquis cash receipts for the period October 1, 2006, through December 31, 2007. Because credit card receipts account for the majority of the Marriott Marquis' cash receipts, we requested third-party credit card processor reports detailing Marriott Marquis credit card terminal activity for rooms, catering, food and beverage, and other charges. We also requested Marriott Marquis' monthly bank statements evidencing electronic fund transfer payments received from credit card processors. However, Marriott Marquis officials informed us that with regard to third-party credit card processor reports, "we can not [sic] get past activity from the years in question." Marriott Marquis officials also informed us credit card processors do not remit payments directly to the Marriott Marquis. Rather, these payments are made to a Marriott Hotel Group centralized processing center and then sent back to the Marriott Marquis net of expenses. Because we were not able to perform intended or alternative procedures, we were not able to determine whether the Marriott Marquis accurately reported gross operating revenue and paid the City all revenue due it.

For the period January 1, 2008, through December 31, 2010, the Marriott Marquis made real estate tax-based payments. Therefore, we were able to verify Marriott Marquis' payments for this period.

The scope of this audit was October 1, 2006, through December 31, 2010. We conducted additional tests subsequent and prior to this period to evaluate current controls and to expand on the effects of certain audit findings.

To identify and understand the Marriott Marquis' and the City's rights and responsibilities, we reviewed the terms of the original lease and three-party Agreement dated July 2, 1982, the first amendment dated September 30, 1986, and the second amendment dated January 29, 1999. We also interviewed DCAS, EDC, and OMB officials regarding their respective lease

administration roles and responsibilities. Additionally, we reviewed the prior New York State Office of the Auditor General Final Report on Financial Operations of the Marriott Marquis Hotel and Rent Payable by Times Square Hotel Company for Lease Years 1986-1988 (MM8A) issued on October 15, 1990, and the New York City Comptroller's Audit Report on The Marriott Marquis Hotel's Compliance with Its Lease Agreement October 1, 1990, to September 30, 1995 (FN97-116A) issued on May 27, 1997.

To obtain an understanding of the Marriott Marquis' controls over and procedures for receiving, recording, and reporting revenue, we interviewed Marriott Marquis officials and reviewed the Marriott Marquis':

- Accounts Receivable, Cash Management, Catering Revenue, Food and Beverage Outlet Revenue, and Rooms Revenue Property Narratives;
- Chart of Accounts;
- Consolidated Profit and Loss Statements for 2006 and 2007; and
- Certified Financial Statements for Fiscal Years 2006, 2007, and 2008.

Although we could not verify the accuracy of payments for the period October 1, 2006, to December 31, 2007, we determined whether the Marriott Marquis properly calculated payments. For the period October 1, 2006, to December 31, 2007, the Marriott was required to pay the greatest of: 5 percent of gross operating revenues; 95 percent of the prior period payment; or \$900,000. We calculated percentage payments based on gross operating revenues and prior period payments reported on Marriott Marquis Statements of Gross Operating Revenues and Excluded Revenues and Statements of Rent, determined applicable payments, and compared them to payments reported and made to EDC.

For the period January 1, 2008, to December 31, 2010, the Marriott was required to make payments "as such payments would be due and payable if such payments were real property taxes assessed and levied against the Premises." We calculated payments based on Finance's assessed property values and applicable tax rates for each tax year ending June 30 and compared them to payments reported and made to EDC.

We then reviewed EDC account ledgers and cash receipts journal entries detailing payment amounts and dates to determine whether the Marriott Marquis remitted payments within specified timeframes. Specifically, for revenue-based payments for the period October 1, 2006, to December 31, 2007, we determined whether estimated payments were submitted by July 1 and December 31, and whether true-up payments were submitted within 120 days after each lease year-ending December 31. For real estate-based payments for the period January 1, 2008, to December 31, 2010, we determined whether payments were submitted by January 1 and July 1.

To determine whether EDC transferred all Marriott Marquis payments to OMB, and in turn, whether OMB credited all Marriott Marquis payments to DCAS, we reviewed EDC's bank account wire transfer notices, cash receipt journal entries, copies of check stubs, and DCAS Tenant Account Reconciliation and TAS Query Account History.

To determine whether the Marriott Marquis complied with and fulfilled lease impositions terms, we reviewed applicable Marriott Marquis, Finance, and Department of Environmental Protection (DEP) billing and payment records. Specifically, we reviewed Finance's NYCeFile Business and Excise Tax Payment Service to verify that the Marriot Marquis paid Hotel Room Occupancy



Taxes, and we reviewed Finance Quarterly Statement of Accounts to verify that the Marriott Marquis paid Business Improvement District Assessments and other taxes and fees.

To determine whether the Marriott Marquis paid its water and sewer charges due, we compiled a list of Marriott Marquis water and sewer accounts by: identifying Marriott Marquis property addresses; inputting addresses into the Department of Buildings' Buildings Information System to yield property borough, block, and lot numbers (BBLs); and inputting BBLs in DEP's Customer Information System (CIS). For each account, we reviewed CIS Customer Bill Detail screens, which detail bill due dates as well as prior, current, and total charges due. We then reviewed CIS Accounts Receivable Transaction History screens to verify that the Marriott Marquis subsequently paid its water and sewer charges due.

To determine whether the Marriott Marquis complied with and fulfilled lease insurance terms, we reviewed Marriott Marquis' insurance policies, certificates, and schedules. We verified whether the Marriott Marquis maintained required coverage amounts and types of insurance, and named the City as an additional insured.

To determine whether DCAS adequately monitored the Marriott Marquis' performance and enforced lease terms in a timely manner, we interviewed DCAS officials, reviewed lease files, and requested prior audits and other financial or compliance reviews. We also obtained written confirmation of DCAS' monitoring efforts of the Marriott Marquis' compliance with fiscal, imposition, and insurance lease terms.

We requested that EDC, DCAS, and OMB officials provide us any correspondence, memorandums, and analyses related to the second lease amendment dated January 29, 1999. We also independently reviewed, evaluated, and conducted comparative analyses of original and amended purchase, payment, interest, and other significant terms to determine whether amended terms were fair, equitable, and in the City's best interests. Specifically, we estimated the original purchase price based on Finance property assessments and compared it to the amended purchase price that is based on the greater of: the base purchase price, plus interest, and less the sum of discounted base rent payments amount, or \$19.9 million. Further, for the period October 1, 1998, to December 31, 2007, we calculated rents payable under the original and amended lease terms and quantified the difference.

## APPENDIX I

### Schedule of Accrued Unpaid Rent Interest Due the City

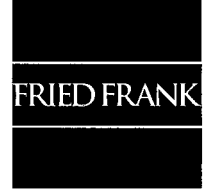
<b>Calculation of Initial Accrued Unpaid Rent Interest Payment</b>					
Accrued Unpaid Rent Principal	Interest Period		Number of Days	Semi-Annual Compound Interest Rate	Initial Interest Payment Due
	From	To			
\$112,721,116	10/01/98	01/28/99	120	5.04%	<b>\$1,867,773</b>
<b>Calculation of Interest Accumulated on Initial Accrued Unpaid Rent Interest Payment Due the City</b>					
Accrued Unpaid Rent Principal	Interest Period		Number of Days	Semi-Annual Compound Interest Rate	Interest Payment Due
	From	To			
\$1,867,773	01/29/99	07/01/99	153	5.04%	\$39,460
1,907,233	07/01/99	01/01/00	184	5.04%	48,457
1,955,690	01/01/00	07/01/00	182	5.04%	49,148
2,004,839	07/01/00	01/01/00	184	5.04%	50,937
2,055,776	01/01/01	07/01/01	181	5.04%	51,380
2,107,156	07/01/01	01/01/02	184	5.04%	53,537
2,160,692	01/01/02	07/01/02	181	5.04%	54,002
2,214,694	07/01/02	01/01/03	184	5.04%	56,269
2,270,963	01/01/03	07/01/03	181	5.04%	56,758
2,327,721	07/01/03	01/01/04	184	5.04%	59,141
2,386,862	01/01/04	07/01/04	182	5.04%	59,820
2,446,682	07/01/04	01/01/05	184	5.04%	61,993
2,508,676	01/01/05	07/01/05	181	5.04%	62,699
2,571,375	07/01/05	01/01/06	184	5.04%	65,331
2,636,706	01/01/06	07/01/06	181	5.04%	65,899
2,702,605	07/01/06	01/01/07	184	5.04%	68,665
2,771,270	01/01/07	07/01/07	181	5.04%	69,262
2,840,532	07/01/07	01/01/08	184	5.04%	72,170
2,912,702	01/01/08	07/01/08	182	5.04%	72,999
2,985,701	07/01/08	01/01/09	184	5.04%	75,651
3,061,352	01/01/09	07/01/09	181	5.04%	76,512
3,137,864	07/01/09	01/01/10	184	5.04%	79,724
3,217,588	01/01/10	07/01/10	181	5.04%	80,417
3,298,005	07/01/10	01/01/11	184	5.04%	83,793
3,381,797	01/01/11	07/01/11	181	5.04%	84,521
3,466,318	07/01/11	01/01/12	184	5.04%	88,069
\$3,554,387	01/01/12	07/01/12	182	5.04%	\$89,081
<b>Total Accrued Unpaid Rent Plus Interest Due the City as of July 1, 2012</b>					<b>\$3,643,468</b>

Summary of Adverse Effects of Lease Amendment

Provision	Original Lease Terms	Lease Amendment Effective October 1, 1998	Adverse Effect
<p><b>Purchase Price</b></p>	<ul style="list-style-type: none"> <li>▪ Fair Market Value of the Land</li> </ul>	<ul style="list-style-type: none"> <li>▪ The greater of:                             <ul style="list-style-type: none"> <li>a) Base Purchase Price of \$25 million + Interest – Discounted Payments), or</li> <li>b) \$19.9 million</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Loss on Property Sale:                             <ul style="list-style-type: none"> <li>a.) In 1998, \$75 million</li> <li>b.) Currently \$173.1 million</li> </ul> </li> </ul>
<p><b>Base Rent</b></p>	<ul style="list-style-type: none"> <li>▪ Required to make minimum payments and allowed to defer balances until lease expiration or purchase option is exercised.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Allowed to pay back deferred balances in lieu of current year rent</li> </ul>	<ul style="list-style-type: none"> <li>▪ Reduce Rental Income                             <ul style="list-style-type: none"> <li>a.) Amortization of deferred rent balances resulted in a loss of \$171.8 million</li> <li>b.) Shortened rental payment period by up to 40 years</li> </ul> </li> </ul>

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December 14, 2012

***Via Hand Delivery and Electronic Mail***

City of New York  
Office of the Comptroller  
Bureau of Audit  
Municipal Building  
One Centre Street, Room 1100  
New York, NY 10007-2341  
Attn: Tina Kim

**Re: *Marriott's Written Response to the New York City Comptroller's Office's Draft Audit Report on the Compliance of the Marriot Marquis with its City Lease Agreement (FK12-065A)***

Dear Ms. Kim:

We are counsel to Host Hotels and Resorts, L.P. ("Marriott"), the owner of HMC Times Square Hotel LLC, the Tenant under the lease with the Empire State Development Corporation dated July 2, 1982 for the premises at 1535 Broadway in New York City (as amended, the "Lease"). On behalf of Marriott, we respectfully submit this written response to the draft Audit Report on the Compliance of the Marriott Marquis with its City Lease Agreement (the "Draft Report"), prepared by the New York City Office of the Comptroller (the "Comptroller") and dated November 30, 2012. The Draft Report contains several errors, which should be corrected before the Draft Report is finalized and published. Moreover, any publication of the Draft Report should include this response.

In the Draft Report, the Comptroller erroneously contends that Marriott owes New York City (the "City") \$3,643,468, representing \$1,867,773 in interest on Accrued Unpaid Rent that was allegedly due but unpaid in January 1999, plus accumulated interest, under the Lease. Contrary to the Comptroller's conclusion, Marriott has made all required payments under the Lease.

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**I. The Marriott Marquis Made All Required Payments Under the Lease**

On July 2, 1982, HMC Times Square Hotel LLC,<sup>1</sup> as Tenant, and Times Square Hotel, Inc., a subsidiary of the Empire State Development Corporation (formerly known as the New York Urban Development Corporation), as Landlord (the “Landlord”), entered into a 75-year lease (the “Original Lease”) that provided for the development of a first-class hotel at 1535 Broadway in New York City. A copy of the Original Lease is attached as **Exhibit A**. The Original Lease required Marriott to pay the Landlord “Base Rent” for each year of the 75-year lease term, a portion of which was payable annually (defined in the Original Lease as the “Minimum Payment”), and the balance of which could be deferred until either the anticipated sale of the land to Marriott or the expiration of the lease in 2057. *See* Ex. A, §§ 3.03-3.06.

In 1998, Marriott and the Landlord amended the Original Lease pursuant to the Second Amendment to Agreement of Lease, dated as of October 1, 1998 (the “Second Amendment,” a copy of which is attached as **Exhibit B**).

The Second Amendment substantially amended the provisions of the Original Lease pertaining to Marriott’s payment obligations. Among other things, Article 3 of the Original Lease, titled “Rent,” was deleted entirely and replaced with the payment provisions set forth in Sections 3.01 to 3.24 of the Second Amendment. *See* Ex. B, ¶ 3. At the time of the Second Amendment, there was \$112.7 million of “Accrued Unpaid Rent” that was deferrable until 2057 (or upon the sale of the land to Marriott). The Second Amendment provided that this amount would bear interest at 5.04% beginning on October 1, 1998, and that future rent payments would be used to pay down the Accrued Unpaid Rent according to an amortization schedule attached to the Second Amendment as Schedule A-1. That schedule provided for the Accrued Unpaid Rent (and associated interest) to be paid off by 2017. *See* Ex. B, §§ 3.22(a), (c).

Under the Second Amendment, the only rent payments required to be paid by Marriott are set forth in Section 3.20. The Second Amendment explicitly provides that, “For each Period, *Rent shall equal the Payment Amount calculated pursuant to Section 3.20 hereof.*” Ex. B, § 3.01(b)(i) (emphasis added).

Subsection (a) of Section 3.20 sets forth a formula for Marriott’s payment of rent for the “Fourth Partial Lease Year” – that is, the period from October 1, 1998 (the

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<sup>1</sup> The original tenant under the Lease, Times Square Marquis Hotel, L.P. (formerly known as Times Square Hotel Company), assigned its interest in the Lease to HMC Times Square Hotel LLC pursuant to an Assignment and Assumption of Ground Lease dated as of July 8, 1999.

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commencement date of the Second Amendment) to December 31, 1998.<sup>2</sup> On January 29, 1999, Marriott duly paid the Landlord the sum of \$24,823,355, consisting of the following payment amounts as calculated in accordance with the formula set forth in Section 3.20(a):

- **\$6,997,028**, representing 3% of Gross Operating Revenues for the Fiscal Year closest to January 1, 1998 and ending on the last day of that Period; *plus*
- **\$20 million**, representing an immediate down-payment of a portion of the Accrued Unpaid Rent of \$112.7 million; *plus*
- **\$1,124,625**, representing 25% of Base Rent (as defined under the Original Lease) for the Lease Year beginning on October 1, 1997 and ending on September 30, 1998,<sup>3</sup> *minus*
- **\$3,298,298**, representing rent that Marriott had already paid for the lease year ending September 30, 1998.

The \$24.8 million payment that Marriott made in January 1999 fully satisfied all of Marriott's payment obligation with respect to the Fourth Partial Lease Year. This is clear from Sections 3.22 and 3.23 of the Second Amendment. The Second Amendment refers to two types of rent: (1) "Accrued Unpaid Rent" under Section 3.22, and (2) "Base Rent"<sup>4</sup> under Section 3.23:

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<sup>2</sup> Section 3.20(a) states as follows:

For each Period beginning on or after the Amendment Date, there shall be an amount ("Payment Amount"), calculated pursuant to the following provisions: (a) For the Fourth Partial Lease Year, the Payment Amount shall equal (i) Three Percent (3%) of Gross Operating Revenues for the period beginning on the first day of the Fiscal Year closest to January 1, 1998 and ending on the last day of such Period, plus (ii) Twenty Million Dollars (\$20,000,000.00), plus (iii) Twenty-Five Percent (25%) of the total amount of Base Rent that would have been payable by Tenant to Landlord pursuant to the Original Lease (which amount may be the Minimum Payment as defined therein if the same would have been payable under the terms thereof) for the Lease Year beginning on October 1, 1997 and ending on September 30, 1998 (as such total amount of payments is adjusted, if at all, pursuant to the audit with respect to the Lease Year ended September 30, 1998 in accordance with Section 3.24(b)(ii) hereof), minus (iv) Three Million Two Hundred Ninety-Eight Thousand Two Hundred Ninety-Eight Dollars (\$3,298,298.00).

<sup>3</sup> As discussed below, Marriott and the Landlord engaged in discussions regarding this portion of the Fourth Partial Lease Year payment, resulting in Marriott paying the Landlord a *higher* amount than originally calculated.

<sup>4</sup> "Base Rent" under Section 3.23 of the Second Amendment should not be confused with "Base Rent" under Section 3.03 of the Original Lease, which refers to rent based on a percent of Gross Operating Revenues for a given payment period. Section 3.03 of the Original Lease, along with other provisions of Article 3 ("Rent"), was amended and restated in its entirety upon the execution of the Second Amendment. *See* Ex. B, ¶ 3.

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1. “**Accrued Unpaid Rent**” is the sum of accrued rent payable under the terms of the Original Lease at the time of the execution of the Second Amendment. Under Section 3.22(a), the amount of Accrued Unpaid Rent is that set forth in Schedule A-1 attached to the Lease, which contains the “Scheduled Payments” for each payment period.<sup>5</sup> The Accrued Unpaid Rent was \$112.7 million at the time of the execution of the Second Amendment. *See* Ex. B, Second Amendment § 3.22.
2. “**Base Rent**” is a formula-based amount arrived at by subtracting, from the payment amounts for each period set forth in Section 3.20, the “Scheduled Payments” of Accrued Unpaid Rent set forth in Schedule A-1. *See* Ex. B, Second Amendment § 3.23(a). That is, Base Rent equals (i) the payment amounts set forth in Section 3.20, minus (ii) the Scheduled Payments of principal and interest on the Accrued Unpaid Rent set forth in Schedule A-1.

The Accrued Unpaid Rent and Base Rent are not *additional* rent payments that Marriott is required to make on top of the Section 3.20 Payment Amounts; rather, they are included in the Section 3.20 payments. Section 3.22(c) explicitly states that “*Included* in the Payment Amount [under Section 3.20(a)] shall be Tenant’s payments of principal and interest on the Accrued Unpaid Rent.” The Second Amendment also explicitly provides that “Rent” payable under the Lease “*shall equal the Payment Amount* calculated pursuant to Section 3.20.” *See* § 3.01(b)(i) (emphasis added). The Comptroller’s contention that Marriott failed to make a \$1.8 million interest payment in 1999 assumes that the Second Amendment provides for interest payments on the Accrued Unpaid Rent to be made in *addition* to the payments required under Section 3.20, which is not the case.<sup>6</sup>

As described above, Marriott made a payment of \$24,823,355 in 1999 for the Fourth Partial Lease Year in accordance with the formula set forth in Section 3.20(a). Pursuant to Section 3.22(c), Marriott’s payment “*Included . . . principal and interest on the Accrued Unpaid Rent*” in accordance with the Payment Schedule set forth in Schedule

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<sup>5</sup> The original Schedule A-1 provides that the Accrued Unpaid Rent is \$114 million, the amount originally calculated by the parties. However, the Second Amendment, at § 3.22(g), provides that that amount is “estimated and subject to change,” and the revised amount of Accrued Unpaid Rent was \$112,721,116, as demonstrated in the revised payment schedule attached as **Exhibit C**.

<sup>6</sup> Notably, in other portions of the Draft Report, the Comptroller criticizes the Economic Development Corporation for advising the City to enter into the Second Amendment when it contained a provision “allowing the Marriott Marquis to amortize Accrued Unpaid Rent in lieu of paying current rents” (Draft Report at 12), thus acknowledging that Marriott’s payments of principal and interest on the Accrued Unpaid Rent were included in Marriott’s rental payments.

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A-1. That schedule provided for payments of principal and interest on the Accrued Unpaid Rent to be made in January 1999 of \$20 million and \$1,867,773, respectively. Thus, pursuant to Section 3.22(c), Marriott's \$24,823,355 payment was allocated as follows: (i) \$20 million of the payment went to pay down the Accrued Unpaid Rent, (ii) \$1,867,773 went to interest on the Accrued Unpaid Rent, and (iii) the remainder, \$2,955,582, went to Base Rent and was applied against the eventual purchase price of the hotel land.

Accordingly, the \$1,867,773 interest payment due in January 1999 was timely paid and all findings and contentions to the contrary are incorrect and should be stricken from the Draft Report.

## II. Contemporaneous Documents Confirm Marriott's Position; the City Is Estopped From Asserting a Default Now

The fact that all required payments were made is confirmed by several documents from the time the interest payment was allegedly due.

*First*, an internal Memorandum dated March 17, 1999 from Dan Kurtz of the Economic Development Corporation ("EDC") to Mark Montgomery and Yvonne Quintian confirms that Marriott made a payment of \$24,823,355 for the Fourth Partial Lease Year. A copy of the EDC's Memorandum is attached as **Exhibit D**. Nowhere in the Memorandum did the EDC reference any missing interest payment by Marriott.<sup>7</sup>

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<sup>7</sup> The Draft Report appears to misconstrue language from the EDC's Memorandum. The Draft Report states that the EDC maintains that a portion – \$1,124,625 – of Marriott's approximately \$24.8 million payment on January 29, 1999 represents the \$1.8 million interest payment at issue. It asserts that the interest payment was reduced based on a "negotiated interpretation of the debt service deduction section of the original lease agreement." The Draft Report appears to be quoting directly from the EDC's Memorandum. However, the EDC was *not* referring to a negotiated reduction of the initial interest payment (which was paid in full by Marriott), but rather to a portion of the payment for the Fourth Partial Lease Year representing the following component of the Payment Amount set forth in Section 3.20(a): "Twenty-Five Percent (25%) of the total amount of Base Rent that would have been payable by Tenant to Landlord pursuant to the Original Lease . . . for the Lease Year beginning on October 1, 1997 and ending on September 30, 1998." The amount originally calculated by Marriott for this portion of the payment was \$856,390, as reflected in the chart labeled "Exhibit I" on page 5 of the February 19, 1999 Memorandum prepared by Marriott's auditors, Arthur Andersen (attached as **Exhibit E**). That amount is less than the amount that is referenced in the EDC Memo and that was ultimately paid by Marriott (\$1,124,625). The difference (\$268,235) appears to be attributable to negotiations between Marriott and the Economic Development Corporation that ultimately resulted in Marriott paying a *higher* amount than the amount calculated by Marriott and its auditors. Indeed, this is the only reasonable interpretation of the EDC's Memorandum: there would have been no reason for the EDC to discuss the \$1.8 million interest payment in the context of just one component of Marriott's \$24.8 million payment for the Fourth Partial Lease Year. Moreover, the EDC's Memorandum refers to the reduction as "an additional negotiated



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**Second**, an internal Arthur Andersen Memorandum dated February 18, 1999 discusses the payment for the Fourth Partial Lease Year in detail and explicitly states that “[a] determined amount of the payment [for the Fourth Partial Lease Year] is applied to interest and the remainder is treated as base rent.” See Ex. E at p. 2. This is unmistakably a reference to the \$1.8 million interest payment. Thus, Marriott’s own auditors recognized that a portion of Marriott’s payment for the Fourth Partial Lease Year was applied to the \$1.8 million interest payment.<sup>8</sup>

**Third**, on June 30, 1999, the Landlord issued an estoppel certificate (attached as **Exhibit G**) certifying that there was no Event of Default and that “[a]ll of the rent and other charges required to be paid by Tenant under the Lease have been duly and timely paid.” The Second Amendment provides that Marriott could rely upon such an estoppel statement.<sup>9</sup> The Landlord’s estoppel certificate thus not only confirms that in 1999 the

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‘give’ extracted *from* Marriott” – i.e., not “*by* Marriott.” Clearly, if the EDC had been referring to a negotiated reduction of the \$1.8 million interest payment at issue, it would have referred to a negotiated “give” extracted *by* Marriott *from* the City. In sum, the EDC does not appear to have ever taken the position that negotiations over a portion of Marriott’s payment for the Fourth Partial Lease Year had anything to do with a negotiated reduction in the \$1.8 million interest payment for that period. That is because there was no such reduction, and Marriott paid all interest due on the Accrued Unpaid Rent.

<sup>8</sup> At the November 15, 2012 meeting between representatives of Marriott, the Comptroller and other City agencies, the Comptroller stated that an audit report from Arthur Andersen provides evidence that Marriott failed to make the \$1.8 million interest payment. The Comptroller subsequently provided that document to Marriott, and it is attached as **Exhibit F**. That document does not provide any evidence of Marriott’s alleged failure to make the \$1.8 million interest payment; in fact, it does not even reference that interest payment. The document includes two Arthur Andersen audit reports, for the periods (i) October 1, 1997 to September 30, 1998 and (ii) January 3, 1998 to January 1, 1999. Those audit reports do not address the interest payment at issue here – i.e., the payment of interest on the Accrued Unpaid Rent for the Fourth Partial Lease Year (i.e., the period from October 1, 1998 to December 31, 1998) – for the likely reason that they are not audits for the Fourth Partial Lease Year period. The audit reports *do* confirm, however, as stated on page 3 of the audit report for the period from January 3, 1998 to January 1, 1999, that “[t]he Amended Ground Lease provides for a portion of the total payment [for each payment period] to be applied towards principal and interest on the deferred ground rent liability outstanding.”

<sup>9</sup> The Second Amendment provides, in pertinent part:

Section 31.02 of the Lease is hereby amended . . . as follows: “Landlord agrees . . . to execute, acknowledge and deliver to Tenant . . . a statement in writing (which may be relied upon by any Person) . . . (b) stating (i) whether or not an Event of Default . . . shall have occurred . . . and (ii) whether or not, to the best knowledge of Landlord, Tenant is in Default in the performance of any covenant, agreement, obligation or condition contained in this Lease, and, if so, specifying, in detail, each such Default or Event of Default, and (c) setting forth

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Landlord understood that there was no Event of Default and that Marriott had made all required payments, it also estops the City from now claiming that Marriott failed to make an interest payment in 1999. *See JRK Franklin, LLC v. 164 E. 87th St. LLC*, 27 A.D.3d 392, 393 (1st Dep’t 2006) (holding landlord could not declare tenant in default under lease after landlord had issued estoppel statement certifying that there was no event of default and tenant detrimentally relied upon statement, particularly where “the lease expressly provides that plaintiff is entitled to rely upon defendant’s representations in the estoppel certificate”).<sup>10</sup>

*Fourth*, Marriott prepared a revised amortization schedule of all payments of principal and interest on the Accrued Unpaid Rent, a copy of which is attached as **Exhibit C**. As reflected in the revised schedule, Marriott made the interest payment of \$1,867,773 on January 28, 1999, and Marriott fully paid off the Accrued Unpaid Rent in 2008.

### **III. Any Claim for Payment of Amounts Allegedly Owed in 1999 Is Barred by the Statute of Limitations**

Finally, any claim for re-payment of the \$1.8 million interest amount at issue is untimely and barred by the statute of limitations. Section 213(2) of New York’s Civil Practice Law and Rules provides for a six-year statute of limitations for actions under contracts.<sup>11</sup> The statute of limitations bars any claim by the Landlord for repayment of

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the amount of Accrued Unpaid Rent most recently certified by Tenant to Landlord and indicating whether or not Landlord is then disputing the amount of Accrued Unpaid Rent so certified by Tenant. . . .”

*See* Ex. B, Second Amendment at p. 7, ¶ 7(o) (emphasis added).

<sup>10</sup> The Draft Report assumes that both Marriott and the City somehow overlooked a missed interest payment just after they had executed the Second Amendment. However, it is simply inconceivable that Marriot would have defaulted under its Lease by failing to make an interest payment of under \$2 million contemporaneously with its entering into the Second Amendment. It is likewise inconceivable that the City would have failed to notice that Marriott failed to make a required payment at the same time as it made a substantial lump-sum payment to the City of *over \$20 million*. Indeed, the only reasonable explanation is that both Marriott and the City *knew* that the interest payment was included in Marriott’s \$24.8 million payment pursuant to Section 3.20(a) of the Second Amendment.

<sup>11</sup> CPLR 213 provides as follows: “The following actions must be commenced within six years: . . . 2. an action upon a contractual obligation or liability, express or implied, except as provided in section two hundred thirteen-a of this article or article 2 of the uniform commercial code or article 36-B of the general business law.” The statute of limitations began to run at the time the Landlord’s cause of action accrued – that is, at the time of the alleged breach of the Lease – regardless of whether the Landlord was aware of the alleged breach. *Ely-Cruikshank Co. v. Bank of Montreal*, 81 N.Y.2d 399, 402-03 (1993). *See also Vigilant Ins. Co. of Am. v. Hous. Auth.*, 87 N.Y.2d 36, 45 (1995) (“[W]hen a contract provides for the payment of money in installments, such as interest installments, the Statute of Limitations runs on each installment

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an amount allegedly owed in 1999. If the Landlord believed Marriott missed a required payment, it was required to bring a claim for payment no later than 2005. Any claim now would be *seven years* too late.

This is precisely the kind of dispute that the statute of limitations is designed to avoid. As courts have long recognized, the statute of limitations is “designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared.” *Blanco v. AT&T Co.*, 90 N.Y.2d 757, 773 (N.Y. 1997) (“Other considerations include promot[ing] repose by giving security and stability to human affairs . . . , judicial economy, discouraging courts from reaching dubious results, recognition of self-reformation by defendants, and the perceived unfairness to defendants of having to defend claims long past.”) (citations and internal quotation marks omitted).<sup>12</sup> Here, memories have faded, contemporaneous documentation has been lost, and most of the Marriott and City employees who were involved in negotiating the Second Amendment and paying and receiving Marriott’s rent payment for the Fourth Partial Lease Year in 1998 have long since moved on to other positions or careers. In these circumstances, any legal action brought to demand Marriott’s repayment of the \$1.8 million interest amount would be dismissed as untimely.<sup>13</sup>

#### IV. Concluding Statement

In sum, the Comptroller’s contention that Marriott failed to pay interest of \$1.8 million on Accrued Unpaid Rent for the Fourth Partial Lease Year is erroneous and should be stricken from the final Audit Report.

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from the date it becomes due.”). Thus, the statute of limitations began to run at the time of the alleged breach in 1999, and any claim brought after 2005 would be untimely.

<sup>12</sup> See also *Order of Railroad Telegraphers v. Railway Express Agency, Inc.*, 321 U.S. 342, 348 (1944) (“[E]ven if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them.”); *John J. Kassner & Co. v. New York*, 389 N.E.2d 99, 103 (N.Y. 1979) (the statute of limitations both ensures a defense against “stale claims” and “expresses a societal interest or public policy of giving repose to human affairs”) (citations and internal quotation marks omitted).

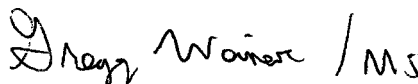
<sup>13</sup> This response does not address the other conclusions and recommendations of the Draft Report because the only recommendation as to Marriott concerns the interest payment discussed herein. However, we note that Marriott disagrees with the Comptroller’s conclusion that the Second Amendment was not in the City’s best interest. By way of example, the Draft Report fails to recognize the significant benefits to the City that resulted from putting the hotel on the City’s tax rolls in 2008 pursuant to the Second Amendment, rather than in 2057 under the Original Lease.

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We are available to discuss any aspect of the foregoing with you if you have any questions regarding Marriott's position.

Very truly yours,

Handwritten signature of Gregg L. Weiner in cursive, followed by a vertical line and the initials "MS".

Gregg L. Weiner

Encls.

cc: Mr. David Buckley, Esq., Host Hotels (via FedEx)  
Mr. Bulent Celik, EDC (via FedEx)  
Mr. William Andersen, Comptroller's Office (via electronic mail w/out encls.)  
Mr. Zak Darwish, Marriott Marquis (via electronic mail w/out encls.)  
Mr. Spencer Hobson, EDC (via electronic mail w/out encls.)



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December 14, 2012

H. Tina Kim  
Deputy Comptroller for Audit  
Office of the Comptroller  
One Centre Street, Room 1100  
New York, NY 10007-2341

Re: Audit Report on the Compliance of  
the Marriott Marquis with Its City  
Lease Agreement (FK12-065A)

Dear Ms. Kim:

The Department of Citywide Administrative Services (DCAS) appreciates the opportunity to reply to the referenced Audit Report. For the reasons stated below, DCAS does not concur with the main conclusions of this Audit.

The construction of the Marriott Marquis Hotel ("Marriott") in Times Square was one in a series of undertakings in the redevelopment and revitalization of the Times Square area. At that time, the Times Square area was facing significant challenges to appeal broadly to local and international tourists as well as to generate interest as a growing place of business and economic activity. The series of agreements that enabled this venture to proceed is unusual in complexity and the allocation of responsibilities. The initial agreements were executed in 1982, and the lease was renegotiated in 1999.

Indeed, this audit covered activities which occurred nearly 14 years ago, and it should come as no surprise that the principals who negotiated this transaction are no longer employed by the New York City Economic Development Corporation (EDC). Therefore these individuals are not available to address or clarify the audit concerns regarding the activities during that period.

As discussed with the auditors, the renegotiation agreement allowed Marriott to apply prospective base rent payments to offset deferred rent

payable as well as retire the economic development grant debt – Urban Development Action Grant (UDAG) – associated with this project. It has been the mutual understanding of the Marriott, EDC and DCAS, that the interest due in 1999 was negotiated to a lesser amount as part of this deal, and included as a subset of an initial payment of \$28.97 million from the Marriott to the City. The then Executive Vice President of EDC, in a memo dated March 17, 1999, stated that the total amount paid included “an additional 25% of what would have been payable for the lease year under a negotiated interpretation of the debt service deduction section of the original lease (\$1,124,625).”[underlines added]

However, the auditors maintain that this interest payment was not negotiated to a lesser amount nor included in the negotiated closing payment; instead they claim that the Marriott still owes the City \$1.8 million plus interest since that time (\$3.6 million in total). Indeed, it is DCAS’ understanding that this obligation was satisfied as part of the closing of the deal.

Furthermore, with respect to pursuing the amounts identified in the Audit, we must note that the statute of limitations for contract claims is generally limited to six (6) years, and as previously mentioned, that under the terms this agreement, Marriott was permitted to offset deferred rent and interest amounts from future base rent payments. Consequently, we must conclude a) that these monies are not owed, b) due to the lapse in time between 1999 and now, pursuing such an audit claim would disregard significant legal challenges, and c) under the terms of this agreement, any monies due would have already been offset against future rent payments, resulting in no net additional monies to the City.

With respect to monitoring the Marriott lease agreement, we must point out that DCAS administers many City leases and allocates its audit resources on a risk-based approach. It is true, in the case of the Marriott, that there has been reliance by DCAS on the work of public accounting and auditing firms in determining annual revenues. DCAS is not aware nor does it have any reason to believe that there were any material misstatements in these documents. Therefore, DCAS has utilized them and assessed this lease to be of lower risk than others.

Lastly, we should mention that the prior Audit of the Marriott Marquis (FN97-116A) by the City Comptroller dated May 27, 1997 did not report any deficiency in DCAS practices as they relate to this lease. DCAS’ practices regarding Marriott have not changed since that time. Furthermore, it should also be noted that since 2008, the rent for the Marriott is based upon the property’s Real Estate Tax, rather than its revenues as reported by the auditors.

Following is the Department's response to each DCAS recommendation:

Recommendations

2. DCAS should ensure that the Marriott Marquis remits \$3,643,468 to the City.

Response 2: Disagree. As explained above, neither DCAS, EDC, nor the Marriott can rationalize that these monies are due. Furthermore, even if DCAS believed otherwise, the attempt to collect the debt would either face significant legal challenges or the funds would be offset against future rent payments. We therefore respectfully decline this recommendation.

3. With respect to lessees that pay revenue based rents, DCAS should conduct routine audits or other reviews to ensure that lessees retain required financial records, accurately report revenues, and pay the City all money due it.

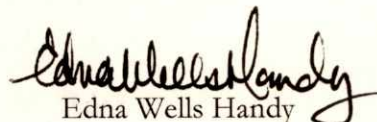
Response 3: Not Applicable. DCAS currently utilizes a risk-based approach to target audits of individual leases. In this situation the Marriott rent is currently based upon the Real Estate Tax rather than its revenues. It is unlikely that this lease will be deemed a high risk item in the future.

4. With respect to lessees that pay revenue based rents, DCAS should take appropriate enforcement action and follow-up in a timely manner on lessees' non-compliance.

Response 4: Not Applicable. Since the rent on the Marriott lease is based upon the value of Real Estate Taxes, this recommendation does not pertain to this lease. The DCAS Long Term Leasing Unit handles this function for other DCAS leases where such actions are warranted.

I trust this information is responsive to your inquiry. Please feel free to contact Christopher Lane, the Director of Internal Audit and Compliance, if you need anything further. Thank you.

Sincerely,

  
Edna Wells Handy



December 14, 2012

Ms. Tina Kim  
Deputy Comptroller for Audits  
The City of New York  
Office of the Comptroller  
1 Centre Street  
New York, New York 10007-2341

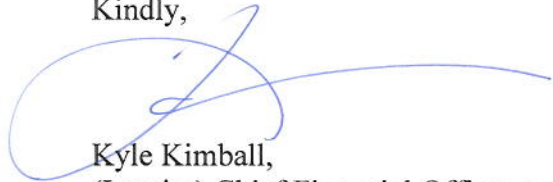
Re: Audit Report on the Compliance of the Marriott Marquis with Its City Lease Agreement  
FK12-065 A

Dear Ms. Kim:

Please find attached our response to the above referenced Draft Audit Report, dated November 30, 2012.

If you or members of your staff have any questions please feel free to contact Mr. Spencer Hobson, Director of Finance, at (212) 312-3503.

Kindly,



Kyle Kimball,  
(Interim) Chief Financial Officer and Chief Operating Officer

Attachment

cc: Seth Pinsky  
Kim Vaccari  
Spencer Hobson  
Bulent Celik  
Brian Halber  
Joseph Horowitz  
George Davis, Mayor's Office of Operations



**Responses to the Comptrollers Audit: Marriott Marquis**

**Comptroller Recommendation #5:** *“Exercise due care and diligence to determine and document whether lease terms are fair, equitable, and in the City’s best interest. This should include, but not be limited to, conducting and retaining comparative quantitative analyses of the financial related terms.”*

**NYCEDC Response:** This recommendation has been NYCEDC’s long-standing practice, even prior to this audit.

NYCEDC retains all official records based on industry best practices, which is at least 7 years. Considering this audit required documentation and institutional knowledge from 15 years ago, from employees no longer with the company, it would be difficult for any organization to identify and locate all requested and related documents.

NYCEDC believes the Comptroller’s analysis is flawed in that it fails to measure the overall beneficial economic impact on the Times Square area. NYCEDC’s mission is to seek to maximize value taking into account anticipated community and economic development, relief and reduction of unemployment, growth in employment, and the development and retention of business. We believe this is a more appropriate measure of the ‘City’s best interests’ than the Comptroller’s staff used in their analysis and recommendations. The Marriott Marquis served as a major catalyst for economic growth for the Times Square area and New York City overall.

**Comptroller Recommendation #6:** *“Document the advantages and disadvantages of proposed terms.”*

**NYCEDC Response:**

This recommendation has been NYCEDC’s long-standing practice, even prior to this Comptrollers’ audit.

NYCEDC retains all official records based on industry best practices, which is at least 7 years. Considering this audit required documentation and institutional knowledge from 15 years ago, from employees no longer with the company, it would be difficult for any organization to identify and locate all requested and related documents.

**Comptroller Recommendation #7:** *“Publicly disclose and discuss significant proposed lease amendments prior to approval and execution.”*

**NYCEDC Response:**

This recommendation has been NYCEDC’s long-standing practice, even prior to this Comptrollers’ audit.

Every real estate transaction NYCEDC enters into is documented and approved by a Real Estate Committee and the Board of Directors. The board minutes of these meetings are public record and accessible to any interested party at the following weblink: <http://www.nycedc.com/about-nycedc/financial-public-documents>. Furthermore, the terms of the second amendment were fully disclosed and discussed with all parties to the transaction as documented by memorandum provided to the Comptrollers’ Office.